U.S. Department of Justice
Antitrust Division

U.S. Department of Justice Merger Guidelines

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1. PURPOSE AND UNDERLYING POLICY ASSUMPTIONS

1.0 These Guidelines state in outline form the present enforcement policy of the U.S. Department of Justice ("Department") concerning acquisitions and mergers ("mergers") subject to section 7 of the Clayton Act[1] or section 1 of the Sherman Act.[2] They describe the general principles and specific standards normally used by the Department in analyzing mergers.[3] By stating its policy as simply and clearly as possible, the Department hopes to reduce the uncertainty associated with enforcement of the antitrust laws in this area.

Although the Guidelines should improve the predictability of the Department's merger enforcement policy, it is not possible to remove the exercise of judgment from the evaluation of mergers under the antitrust laws. Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, strict application of those standards may provide misleading answers to the economic questions raised under the antitrust laws. Moreover, the picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines. Therefore, the Department will apply the standards of the Guidelines reasonably and flexibly to the particular facts and circumstances of each proposed merger.

The Guidelines are designed primarily to indicate when the Department is likely to challenge mergers, not how it will conduct the litigation of cases that it decides to bring. Although relevant in the latter context, the factors

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[1]15 U.S.C. § 18 (1982). Mergers subject to section 7 are prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly."

[2]15 U.S.C. § 1 (1982). Mergers subject to section 1 are prohibited if they constitute a "contract, combination..., or conspiracy in restraint of trade."

[3]They update the Guidelines issued by the Department in 1982. The Department may from time to time revise the Merger Guidelines as necessary to reflect any significant changes in enforcement policy or to clarify aspects of existing policy.

contemplated in the standards do not exhaust the range of evidence that the Department may introduce in court.[4]

The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance "market power" or to facilitate its exercise. A sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Where only a few firms account for most of the sales of a product, those firms can in some circumstances either explicitly or implicitly coordinate their actions in order to approximate the performance of a monopolist. This ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time is termed "market power." Sellers with market power also may eliminate rivalry on variables other than price. In either case, the result is a transfer of wealth from buyers to sellers and a misallocation of resources.

"Market power" also encompasses the ability of a single buyer or group of buyers to depress the price paid for a product to a level that is below the competitive price. The exercise of market power by buyers has wealth transfer and resource misallocation effects analogous to those associated with the exercise of market power by sellers.

Although they sometimes harm competition, mergers generally play an important role in a free enterprise economy. They can penalize ineffective management and facilitate the efficient flow of investment capital and the redeployment of existing productive assets. While challenging competitvely harmful mergers, the Department seeks to avoid unnecessary interference with that larger universe of mergers that are either competitively beneficial or neutral. In attempting to mediate between these dual concerns, however, the Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency.

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[4]Parties seeking more specific advance guidance concerning the Department's enforcement intentions with respect to any particular merger should consider using the Business Review Procedure. 28 C.F.R. § 50.6.

2. MARKET DEFINITION AND MEASUREMENT

2.0 Using the standards stated below, the Department will define and measure the market for each product or service (hereinafter "product") of each of the merging firms. The standards in the Guidelines are designed to ensure that the Department analyzes the likely competitive impact of a merger within economically meaningful markets—i.e., markets that could be subject to the exercise of market power. Accordingly, for each product of each merging firm, the Department seeks to define a market in which firms could effectively exercise market power if they were able to coordinate their actions. Formally, a market is defined as a product or group of products and a geographic area in which it is sold such that a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a "small but significant and nontransitory" increase in price above prevailing or likely future levels. The group of products and geographic area that comprise a market will be referred to respectively as the "product market" and the "geographic market."

In determining whether one or more firms would be in a position to exercise market power, it is necessary to evaluate both the probable demand responses of consumers and the probable supply responses of other firms. A price increase could be made unprofitably by any of four types of demand or supply responses: 1) consumers switching to other products; 2) consumers switching to the same product produced by firms in other areas; 3) producers of other products switching existing facilities to the production of the product; or 4) producers entering into the production of the product by substantially modifying existing facilities or by constructing new facilities. Each type of response is considered under the Guidelines.

In determining whether any of these responses are probable, the Department usually must rely on historical market information as the best, and sometimes the only, indicator of how the market will function in the future. It is important to note, however, that the Guidelines are fundamentally concerned with probable future demand or supply responses.

Sections 2.1 through 2.4 describe how product and geographic markets will be defined under these Guidelines and how market shares will be calculated.

2.1 Product Market Definition

2.11 General Approach

The Department will first detemine the relevant product market with respect to each of the products of each of the merging firms. In general, the Department will include in the product market a group of products such that a hypothetical firm that was the only present and future seller of those products (a "monopolist") could profitably impose a "small but significant and nontransitory" increase in price. That is, assuming that buyers could respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If readily available alternatives were, in the aggregate, sufficiently attractive to enough buyers, an attempt to raise price would not prove profitable, and the tentatively identified product group would prove to be too narrow.

Specifically, the Department will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed a "small but significant and nontransitory" increase in price.[5] If the price increase would cause so many buyers to shift to other products that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Department will add to the product group the product that is the next-best substitute for the merging firm's product and ask the same question again. This process will continue until a group of products is identified for which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" increase in price. The Department generally will consider the relevant product market to be the smallest group of products that satisfies this test.

In the above analysis, the Department will use prevailing prices of the products of the merging firms and possible substitutes for such products. However, the Department may use likely future prices when changes in the prevailing prices can be predicted with reasonable reliability. Changes in price may be predicted on the basis of, for example, expected changes in regulations that directly affect price.

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[5] Although discussed separately, product market definition and geographic market definition are interrelated. In particular, the extent to which buyers of a particular product would shift to other products in the event of a "small but significant and nontransitory" increase in price must be evaluated in the context of the relevant geographic market.

In general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined.[6] In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the Department in most contexts will use a price increase of five percent lasting one year. However, what constitutes a "small but significant and nontransitory" increase in price will depend on the nature of the industry, and the Department at times may use a price increase that is larger or smaller than five percent.[7] For the purposes of its analysis, the Department will assume that the buyers and sellers immediately become aware of the price increase.

2.12 Relevant Evidence

Although direct evidence of the likely effect of a future price increase may sometimes be available, it usually will be necessary for the Department to infer the likely effects of a price increase from various types of reliable, circumstantial evidence. The postulated "small but significant and nontransitory" price increase provides an objective standard by which to analyze the available evidence. Thus, in evaluating product substitutability, the Department will consider all relevant evidence but will give particular weight to the following factors:

1) Evidence of buyers' perceptions that the products are or are not substitutes, particularly if those buyers have actually considered shifting purchases between the products in response to changes in relative price or other competitive variables;

2) Differences in the price movements of the products or similarities in price movements over a period of years that are not explainable by common or parallel changes in factors such as costs of inputs, income, or other variables;

3) Similarities or differences between the products in customary usage, design, physical composition, and other technical characteristics; and

4) Evidence of sellers' perceptions that the products are or are not substitutes, particularly if business decisions have been based on those perceptions.

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[6]For example, in a merger between retailers, the relevant price would be the retail price of a product to consumers. In the case of a merger among oil pipelines, the relevant price would be the tariff—the price of the transportation service.

[7]For example, a larger increase may be appropriate if the "price" to be increased is a tariff or commission that constitutes a small fraction of the price of the product being transported or sold.

2.13 Price Discrimination

The analysis of product market definition to this point has assumed that price discrimination—charging different buyers different prices for products having the same cost, for example—would not be possible after the merger. Existing buyers sometimes will differ significantly in their assessment of the adequacy of a particular substitute and the ease with which they could substitute it for the product of the merging firm. Even though a general increase in price might cause such significant substitution that it would not be profitable, sellers who can price discriminate could raise price only to groups of buyers who cannot easily substitute away.[8] If such price discrimination is possible, the Department will consider defining additional, narrower relevant product markets consisting of particular uses of the product for which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" increase in price.

2.2 Identification of Firms that Produce the Relevant Product

In most cases, the Department's evaluation of a merger will focus primarily on firms that currently produce and sell the relevant product. In addition, the Department may include other firms in the market if their inclusion would more accurately reflect probable supply responses. The following are examples of circumstances in which such additional firms would be included in the market.

2.21 Production Substitution

The same productive and distributive facilities can sometimes be used to produce and sell two or more products that buyers do not regard as good substitutes. Production substitution refers to the shift by a firm in the use of facilities from producing and selling one product to producing and selling another. Depending upon the cost and speed of that shift, production substitution may allow firms that do not currently produce the relevant product to respond effectively to an increase in the price of that product.[9]

[8] Price discrimination requires that sellers be able to identify those buyers and that other buyers be unable profitably to purchase and resell to them.

[9] Under other analytical approaches, production substitution sometimes has been reflected in the description of the product market. For example, the product market for stamped metal products such as automobile hub caps might be described as "light metal stamping," a production process rather than a product. The Department believes that the approach described in the text provides a more clearly focused method of incorporating this factor in merger analysis. If production substitution among a group of products is nearly universal among the firms selling one or more of those products, however, the Department may use an aggregate description of those markets as a matter of convenience.

If a firm has existing productive and distributive facilities that could easily and economically be used to produce and sell the relevant product within one year in response to a "small but significant and nontransitory" increase in price, the Department will include that firm in the market.[10] In this context, a "small but significant and nontransitory" increase in price will be determined in the same way in which it is determined in product market definition. In many cases, a firm that could readily convert its facilities from the production of one product to another would have significant difficulty distributing or marketing the new product or for some other reason would find the substitution unprofitable. Such firms will not be included in the market. The competitive significance of such firms, as well as those that will not be included in the market because they must construct significant new productive and distributive facilities, will be considered in evaluating entry conditions generally. See Section 3.3 (Ease of Entry).

2.22 Durable Products

Some long-lived products may continue to exert competitive influence after the time of original sale. If, under the standards stated in Section 2.1, recycled or reconditioned products represent good substitutes for new products, the Department will include in the market firms that recycle or recondition those products.

2.23 Internal Consumption

Captive production and consumption of the relevant product by vertically integrated firms are part of the overall market supply and demand. Such firms may respond to an increase in the price of the relevant product in either of two ways. They may begin selling the relevant product, or alternatively, they may continue to consume all of their production but increase their production of both the relevant product and products in which the relevant product is embodied. Either kind of supply response could frustrate collusion by firms currently selling the relevant product. If a firm would be likely to respond either way to a "small but significant and non-

[10]The amount of sales or capacity to be included in the market is a separate question discussed in Section 2.4, below.

transitory'' increase in price, the Department will include that firm in the market. In this context, a ''small but significant and nontransitory'' increase in price will be determined in the same way in which it is determined in product market definition.

2.3 Geographic Market Definition

2.31 General Approach

For each product market of each merging firm, the Department will determine the geographic market or markets in which that firm sells. The purpose of geographic market definition is to establish a geographic boundary that roughly separates firms that are important factors in the competitive analysis of a merger from those that are not. Depending on the nature of the product and the competitive circumstances, the geographic market may be as small as part of a city or as large as the entire world. Also, a single firm may operate in a number of economically discrete geographic markets.

In general, the Department seeks to identify a geographic area such that a hypothetical firm that was the only present or future producer or seller of the relevant product in that area could profitably impose a ''small but significant and nontransitory'' increase in price. That is, assuming that buyers could respond to a price increase within a tentatively identified area only by shifting to firms located outside the area, what would happen? If firms located elsewhere readily could provide the relevant product to the hypothetical firm's buyers in sufficient quantity at a comparable price, an attempt to raise price would not prove profitable, and the tentatively identified geographic area would prove to be too narrow.

In defining the geographic market or markets affected by a merger, the Department will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed a ''small but significant and nontransitory'' increase in price. If this increase in price would cause so many buyers to shift to products produced in other areas that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Department will add the location from which production is the next-best substitute for production at the merging firm's location and ask the same question again. This process will be repeated until the Department identifies an area in which a hypothetical monopolist could profitably impose a ''small but significant and nontransitory'' increase in price. The ''smallest market'' principle will be applied as it is in product market definition. Both the price in which an increase will be

postulated and what constitutes a "small but significant and nontransitory" increase in price will be determined in the same way in which it is determined in product market definition.

2.32 Relevant Evidence

Although direct evidence of the likely effect of a future price increase may sometimes be available, it usually will be necessary for the Department to infer the likely effects of a price increase from various types of reliable, circumstantial evidence. The postulated "small but significant and nontransitory" increase in price provides an objective standard by which to analyze the available evidence. Thus, in evaluating geographic substitutability, the Department will consider all relevant evidence but will give particular weight to the following factors:

1) The shipment patterns of the merging firm and of those firms with which it actually competes for sales;

2) Evidence of buyers having actually considered shifting their purchases among sellers at different geographic locations, especially if the shifts corresponded to changes in relative price or other competitive variables;

3) Differences in the price movements of the relevant product or similarities in price movements over a period of years that are not explainable by common or parallel changes in factors such as the cost of inputs, income, or other variables in different geographic areas;

4) Transportation costs;

5) Costs of local distribution; and

6) Excess capacity of firms outside the location of the merging firms.

2.33 Price Discrimination

The analysis of geographic market definition to this point has assumed that geographic price discrimination—charging different prices net of transportation costs for the same product to buyers in different locations, for example—would not be possible after the merger. As in the case of product market definition, however, where price discrimination is possible,[11] the Department will consider defining additional, narrower geographic markets consisting of particular locations in which a hypothetical monopolist could profitably impose a "small but significant and nontransitory" increase in price.

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[11] Geographic price discrimination against a group of buyers is more likely when other buyers cannot easily purchase and resell the relevant product to them. Such arbitrage is particularly difficult where the product is sold on a delivered basis and where transportation costs are a significant percentage of the final cost.

2.34 Foreign Competition

In general, the foregoing standards will govern market definition, whether domestic or international. Although voluntary or involuntary quotas may prevent foreign competitors from increasing their imports into the United States in response to a domestic price increase, the Department will not exclude foreign competitors from the relevant market solely on the basis of the quotas. This is primarily because it frequently is difficult to determine and measure the effectiveness and longevity of a particular quota or any offsetting supply response from firms in countries not subject to the quota. The Department will consider effects of a quota as a separate factor in interpreting the significance of market shares and market concentration. See Section 3.23 (Special Factors Affecting Foreign Firms).

2.4 Calculating Market Shares

The Department normally will include in the market the total sales or capacity of all domestic firms (or plants) that are identified as being in the market under Sections 2.2 and 2.3. Market shares can be expressed either in dollar terms through measurement of sales, shipments, or production, or in physical terms through measurement of sales, shipments, production, capacity, or reserves. As a practical matter, the availability of data often will determine the measurement basis. When the availability of data allows a choice, dollar sales or shipments generally will be used if branded or relatively differentiated products are involved, and physical capacity, reserves, or dollar production generally will be used if relatively homogeneous, undifferentiated products are involved.

In some cases, however, total sales or capacity may overstate the competitive significance of a firm. The Department will include only those sales likely to be made or capacity likely to be used in the market in response to a "small but significant and nontransitory" increase in price, for example, with respect to firms included in the market under Sections 2.21 (Production Substitution) and 2.23 (Internal Consumption). Similarly, a firm's capacity may be so committed elsewhere that it would not be available to respond to an increase in price in the market. In such cases, the Department also may include a smaller part of the firm's sales or capacity.

To the extent available information permits, market shares will be assigned to foreign competitors in the same way in which they are assigned to domestic competitors. If dollar sales or shipments are used to measure shares of domestic firms, the market shares of foreign firms will be

measured using dollar sales in, or shipments to, the relevant market.[12] If physical capacity, reserves, or dollar production is used for domestic firms, the shares of foreign firms will be measured in terms of the capacity or reserves likely to be used to supply, or production that is likely to be shipped to, the relevant market in response to a "small but significant and nontransitory" price increase. If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not exceed the amount of shipments by such firms allowed under the quota. Current shipments rather than capacity or reserves may be used for foreign firms if it is impossible reliably to quantify the proportion of the firms' capacity, reserves, or production that would be devoted to the relevant market in response to a "small but significant and nontransitory" increase in price because of, for example, the lack of available data regarding foreign capacity or the commitment of such capacity to other markets. Finally, a single market share may be assigned to a country or group of countries if firms in that country or group of countries act in coordination or if necessitated by data limitations.

[12]If exchange rates fluctuate significantly, making comparable dollar calculations for different firms difficult, then the volume of unit sales may be a better measure of market share than dollar sales and may be used instead.

3. HORIZONTAL MERGERS

3.0 Where the merging firms are in the same product and geographic market, the merger is horizontal. In such cases, the Department will focus first on the post-merger concentration of the market and the increase in concentration caused by the merger. For mergers that result in low market concentration or a relatively slight increase in concentration, the Department will be able to determine without a detailed examination of other factors that the merger poses no significant threat to competition. In other cases, however, the Department will proceed to examine a variety of other factors relevant to that question.

3.1 Concentration and Market Shares

Market concentration is a function of the number of firms in a market and their respective market shares.[13] Other things being equal, concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power. The smaller the percentage of total supply that a firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable. If collective action is necessary, an additional constraint applies. As the number of firms necessary to control a given percentage of total supply increases, the difficulties and costs of reaching and enforcing consensus with respect to the control of that supply also increase.

As an aid to the interpretation of market data, the Department will use the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual market shares of all the firms included in the market under the standards in Section 2 of

[13]Markets can range from atomistic, where very large numbers of firms that are small relative to the overall size of the market compete with one another, to monopolistic, where one firm controls the entire market. Far more common, and more difficult analytically, is the large middle range of instances where a relatively small number of firms account for most of the sales in the market.

these Guidelines.[14] Unlike the traditional four-firm concentration ratio, the HHI reflects both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms. It also gives proportionately greater weight to the market shares of the larger firms, which probably accords with their relative importance in any collusive interaction.

The Department divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800). An empirical study by the Department of the size dispersion of firms within markets indicates that the critical HHI thresholds at 1000 and 1800 correspond roughly to four-firm concentration ratios of 50 percent and 70 percent, respectively. Although the resulting regions provide a useful format for merger analysis, the numerical divisions suggest greater precision that is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive concerns. Moreover, because concentration and market share data present a historical picture of the market, the Department must interpret such data in light of the relevant circumstances and the forward-looking objective of the Guidelines—to determine likely future effects of a given merger.

3.11 General Standards

In evaluating horizontal mergers, the Department will consider both the post-merger market concentration and the increase in concentration resulting from the merger.[15] The link between concentration and market power is explained above. The increase in concentration is relevant to several key issues. Although mergers among small firms increase concentration, they are less likely to have anticompetitive consequences. Moreover, even in concentrated markets, it is desirable to allow firms

[14]For example, a market consisting of four firms with market shares of 30 percent, 30 percent, 20 percent and 20 percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about small fringe firms is not critical because such firms do not affect the HHI significantly.

[15]The increase in concentration as measured by the HHI can be calculated independently of the overall market concentration by doubling the product of the market shares of the merging firms. For example, the merger of firms with shares of 5 percent and 10 percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$). The explanation for this technique is as follows: In calculating the HHI before the merger, the market shares of the merging firms are squared individually: $(a)^2 + (b)^2$. After the merger, the sum of those shares would be squared: $(a + b)^2$, which equals $a^2 + 2ab + b^2$. The increase in the HHI therefore is represented by 2ab.

some scope for merger activity in order to achieve economies of scale and to permit exit from the market. However, market share and concentration data provide only the starting point for analyzing the competitive impact of a merger. Before determining whether to challenge a merger, the Department will consider all other relevant factors that pertain to its competitive impact.

The general standards for horizontal mergers are as follows:

a) Post-Merger HHI Below 1000. Markets in this region generally would be considered to be unconcentrated. Because implicit coordination among firms is likely to be difficult and because the prohibitions of section 1 of the Sherman Act are usually an adequate response to any explicit collusion that might occur, the Department will not challenge mergers falling in this region, except in extraordinary circumstances.

b) Post-Merger HHI Between 1000 and 1800. Because this region extends from the point at which the competitive concerns associated with concentration are raised to the point at which they become quite serious, generalization is particularly difficult. The Department, however, is unlikely to challenge a merger in this region producing an increase in the HHI of less than 100 points.[16] The Department is likely to challenge mergers that produce an increase in the HHI of more than 100 points, unless the Department concludes, on the basis of the post-merger HHI, the increase in the HHI, and the presence or absence of the factors discussed in Sections 3.2, 3.3, 3.4, and 3.5, that the merger is not likely substantially to lessen competition.

c) Post-Merger HHI Above 1800. Markets in this region generally are considered to be highly concentrated. Additional concentration resulting from mergers is a matter of significant competitive concern. The Department is unlikely, however, to challenge mergers in this region producing an increase in the HHI of less than 50 points.[17] The Department is likely to challenge mergers that produce an increase in the HHI of more than 50 points, unless the Department concludes, on the basis of the post-merger HHI, the increase in the HHI, and the presence or absence of the factors discussed in Sections 3.2, 3.3, 3.4, and 3.5, that the merger is not likely substantially to lessen competition. However, if the increase in the HHI exceeds 100 and the post-merger HHI substantially exceeds 1800, only in extraordinary cases will such factors establish that the merger is not likely substantially to lessen competition.

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[16]Mergers producing increases in concentration close to the 100 point threshold include those between firms with market shares of 25 percent and 2 percent, 16 percent and 3 percent, 12 percent and 4 percent, 10 percent and 5 percent, 8 percent and 6 percent, and 7 percent and 7 percent.

[17]Mergers producing increases in concentration close to the 50 point threshold include those between firms with market share of 12 percent and 2 percent, 8 percent and 3 percent, 6 percent and 4 percent, and 5 percent and 5 percent.

3.12 Leading Firm Proviso

In some cases, typically where one of the merging firms is small, mergers that may create or enhance the market power of a single dominant firm could pass scrutiny under the standards stated in Section 3.11. Notwithstanding those standards, the Department is likely to challenge the merger of any firm with a market share of at least one percent with the leading firm in the market, provided the leading firm has a market share that is at least 35 percent. Because the ease and profitability of collusion are of little relevance to the ability of a single dominant firm to exercise market power, the Department will not consider the presence or absence of the factors discussed in Section 3.4 because they relate to the likelihood of collusion. The Department will consider, however, the factors in Sections 3.2, 3.3, and 3.5 because they are relevant to the competitive concerns associated with a leading-firm merger.

3.2 Factors Affecting the Significance of Market Shares and Concentration

In a variety of situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market. The following are examples of such situations.

3.21 Changing Market Conditions

Market concentration and market share data of necessity are based on historical evidence. However, recent or on-going changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. For example, if a new technology that is important to long-term competitive viability is not available to a particular firm, the Department may conclude that the historical market share of the firm overstates the firm's future competitive significance. The Department will consider reasonably predictable effects of recent or on-going changes in market conditions in interpreting market concentration and market share data.

3.22 Financial Condition of Firms in the Relevant Market

The Department will consider the financial condition of a merging firm or any firm in the relevant market, to the extent that it is relevant to an analysis of the firm's likely future competitive significance.[18] If the finan-

[18] This factor is distinguished from the failing company doctrine, which is an affirmative defense to an otherwise unlawful merger and which, as noted in Section 5.1, the Department will contrue strictly.

cial difficulties of a firm cannot be explained as phenomena of, for example, the business cycle, but clearly reflect an underlying structural weakness of the firm, the firm's current market share may overstate its likely future competitive significance. For example, a firm's current market share may overstate its future competitive significance if that firm has chronic financial difficulties resulting from obsolete productive facilities in a market experiencing a long-term decline in demand.

3.23 Special Factors Affecting Foreign Firms

Actual import sales, shipment data, or capacity in some cases may tend to overstate the relative competitive significance of foreign firms. This will be the case, for example, if foreign firms are subject to quotas (imposed either by the United States or by their own country) that effectively limit the volume of their imports into this country. Foreign firms that are subject to such quotas generally cannot increase imports into the United States in response to a domestic price increase. In the case of restraints that limit imports to some percentage of the total amount of the product sold in the United States (i. e., percentage quotas), a domestic price increase that reduces domestic consumption would actually reduce the volume of imports into the United States. Thus, actual import sales and shipment data will tend to overstate the competitive significance of firms in countries subject to binding quotas.[19] Less significant, but still important factors, such as other types of trade restraints and changes in exchange rates, also may cause actual import sales and shipment data to overstate the future competitive significance of foreign firms. To the extent that the relative competitive significance of imports is overstated by the current market shares of foreign firms, the relative competitive significance of domestic firms concomitantly will be understated.

In addition, limitations on available data concerning the amount of foreign capacity that could be devoted to the United States in response to a "small but significant and nontransitory" increase in price may require the Department to use market share data that understate the true competitive significance of foreign competitors. Despite the inability to obtain data to quantify precisely the supply response of foreign competitors, the Department will consider strong qualitative evidence that, for example, there is significant worldwide excess capacity that could readily be devoted to the United States. To the extent market shares based on the best available evidence tend to understate the competitive significance of

[19]For example, in the extreme situation where there is an effective trade restraint that places a fixed or percentage limitation on the quantity of goods that can be imported into the United States from all or almost all foreign sources, market shares of foreign sources would usually be accorded little, if any, weight.

foreign competitors, the relative competitive significance of domestic firms may be overstated.

In all cases addressed by Section 3.23 of the Guidelines the Department will make appropriate adjustments in its analysis of the available data to reflect more accurately actual competitive concerns.

3.3 Ease of Entry

If entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market. Under the standards in Section 2.21, firms that do not currently sell the relevant product, but that could easily and economically sell it using existing facilities, are included in the market and are assigned a market share. This section considers the additional competitive effects of 1) production substitution requiring significant modifications of existing facilities and 2) entry through construction of new facilities.[20]

In assessing the ease of entry into a market, the Department will consider the likelihood and probable magnitude of entry in response to a "small but significant and nontransitory" increase in price.[21] Both the price to be increased and what constitutes a "small but significant and nontransitory" increase in price will be determined as they are in product market definition, except that a two-year time period generally will be used.[22] The more difficult entry into the market is, the more likely the Department is to challenge the merger.

3.4 Other Factors

A variety of other factors affect the likelihood that a merger will create, enhance, or facilitate the exercise of market power. In evaluating mergers, the Department will consider the following factors, among others, as they relate to the ease and profitability of collusion. Where relevant, the factors are most likely to be important where the Department's decision whether to challenge a merger is otherwise close.

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[20]"Entry" may occur as firms outside the market enter for the first time or as fringe firms currently in the market greatly expand their current capacity.

[21]In general, entry is more likely to occur when the additional assets necessary to produce the relevant product are short-lived or widely used outside the particular application. Entry is generally facilitated by the growth of the market and hindered by its stagnation or decline. Entry also is hindered by the need for scarce special skills or resources, or the need to achieve a substantial market share in order to realize important economies of scale. See also Section 4.212 (Increased Difficulty of Simultaneous Entry to Both Markets).

[22]Although this type of supply response may take longer to materialize than those considered under Section 2.21, its prospect may have a greater deterrent effect on the exercise of market power by present sellers. Where new entry involves the dedication of long-lived assets to a market, the resulting capacity and its adverse effects on profitability will be present in the market until those assets are economically depreciated.

3.41 Nature of the Product and Terms of Sale

3.411 Homogeneity-Heterogeneity of the Relevant Product Generally

In a market with a homogeneous and undifferentiated product, a cartel need establish only a single price—a circumstance that facilitates reaching consensus and detecting deviation. As the products which constitute the relevant product market become more numerous, heterogeneous, or differentiated, however, the problems facing a cartel become more complex. Instead of a single price, it may be necessary to establish and enforce a complex schedule of prices corresponding to gradations in actual or perceived quality attributes among the competing products.[23]

Product variation is arguably relevant in all cases, but practical considerations dictate a more limited use of the factor. There is neither an objective index of product variation nor an empirical basis for its use in drawing fine distinctions among cases. As a result, this factor will be taken into account only in relatively extreme cases where both identification and effect are more certain. For example, when the relevant product is completely homogeneous and undifferentiated, the Department is more likely to challenge the merge. Conversely, when the relevant product is very heterogeneous or sold subject to complex configuration options or customized production, the Department is less likely to challenge the merger.[24] Over a significant middle range of the spectrum of product variation, this factor is less likely to affect the Department's analysis.

3.412 Degree of Difference Between the Products and Locations in the Market and the Next-Best Substitutes

The market definition standards stated in Section 2 of these Guidelines require drawing relatively bright lines in order to determine the products and sellers to be considered in evaluating a merger. For example, in defining the relevant product, all "good substitutes" in demand are included. The profitability of any collusion that might occur will depend in part, however, on the quality of the next-best substitute. That is, it matters whether the next-best substitute is only slightly or significantly inferior to the last product included in the relevant product. Similarly, it matters whether the next-most-distant seller is only slightly or significantly farther

[23] A similar situation may exist where there is rapid technological change or where supply arrangements consist of many complicated terms in addition to price.

[24] This conclusion would not apply, however, where the significance of heterogeneity is substantially reduced through detailed specifications that are provided by the buyer and that form the basis for all firms' bids.

away than the last seller included in the geographic market. The larger the "gap" at the edge of the product and geographic markets, the more likely the Department is to challenge the merger.

3.413 Similarities and Differences in the Products and Locations of the Merging Firms

There also may be relevant comparisons among the products or sellers included in the market. Where products in a relevant market are differentiated or sellers are spatially dispersed, individual sellers usually compete more directly with some rivals than with others. In markets with highly differentiated products, the Department will consider the extent to which consumers perceive the products of the merging firms to be relatively better or worse substitutes for one another than for other products in the market. In markets with spatially dispersed sellers and significant transportation costs, the Department will consider the relative proximity of the merging firms. If the products or plants of the merging firms are particularly good substitutes for one another, the Department is more likely to challenge the merger.

3.42 Information About Specific Transactions and Buyer Market Characteristics

Collusive agreements are more likely to persist if participating firms can quickly detect and retaliate against deviations from the agreed prices or other conditions. Such deviations are easiest to detect, and therefore least likely to occur, in markets where detailed information about specific transactions or individual price or output levels is readily available to competitors. The Department is more likely to challenge a merger if such detailed information is available to competitors, whether the information comes from an exchange among sellers, public disclosure by buyers, reporting by the press or a government agency, or some other source.

Certain buyer market characteristics also may facilitate detection of deviation from collusive agreements. If orders for the relevant product are frequent, regular, and small relative to the total output of a typical firm in the market, collusion is more likely to succeed because the benefits of departing from the collusive agreement in any single transaction are likely to be small relative to the potential costs. In order to increase its sales significantly in such circumstances, a seller would have to depart from the collusive agreement on a large number of orders. Each such sale takes customers away from other parties to the agreement, a fact that is particularly evident when demand is stable or declining. As a result, the chances of detection and effective response by other sellers increase with the number of such sales. The Department is more likely to challenge a merger where such buyer market characteristics exist.

3.43 Ability of Small or Fringe Sellers to Increase Sales

Collusion is less likely to occur if small or fringe sellers in the market are able profitably to increase output substantially in response to a "small but significant and nontransitory" increase in price and, thus, to undermine a cartel. The Department is less likely to challenge a merger if small or fringe firms currently are able to expand significantly their sales at incremental costs that are approximately equal to their incremental costs experienced at current levels of output.

3.44 Conduct of Firms in the Market

The Department is more likely to challenge a merger in the following circumstances:

a) Firms in the market previously have been found to have engaged in horizontal collusion regarding price, territories, or customers, and the characteristics of the market have not changed appreciably since the most recent finding. The additional concentration resulting from the merger could make explicit collusion more difficult to detect or tacit collusion more feasible.

b) One or more of the following types of practices are adopted by substantially all of the firms in the market: 1) mandatory delivered pricing; 2) exchange of price or output information in a form that could assist firms in setting or enforcing an agreed price; 3) collective standardization of product variables on which the firms could compete; and 4) price protection clauses. Although not objectionable under all circumstances, these types of practices tend to make collusion easier, and their widespread adoption by the firms in the market raises some concern that collusion may already exist.

c) The firm to be acquired has been an unusually disruptive and competitive influence in the market. Before invoking this factor, the Department will determine whether the market is one in which performance might plausibly deteriorate because of the elimination of one disruptive firm.

When the market in which the proposed merger would occur is currently performing noncompetitively, the Department is more likely to challenge the merger. Noncompetitive performance suggests that the firms in the market already have succeeded in overcoming, at least to some extent, the obstacles to effective collusion. Increased concentration of such a market through merger could further facilitate the collusion that already exists. When the market in which the proposed merger would occur is currently performing competitively, however, the Department will apply its ordinary standards of review. The fact that the market is currently competitve casts little light on the likely effect of the merger.

In evaluating the performance of a market, the Department will consider any relevant evidence, but will give particular weight to the following evidence of possible noncompetitive performance when the factors are found in conjunction:

a) Stable relative market shares of the leading firms in recent years;

b) Declining combined market share of the leading firms in recent years; and

c) Profitability of the leading firms over substantial periods of time that significantly exceeds that of firms in industries comparable in capital intensity and risk.

3.5 Efficiencies

The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers. Because the antitrust laws and, thus, the standards of the Guidelines, are designed to proscribe only mergers that present a significant danger to competition, they do not present an obstacle to most mergers. As a consequence, in the majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department.

Some mergers that the Department otherwise might challenge may be reasonably necessary to achieve significant net efficiencies. If the parties to the merger establish by clear and convincing evidence that a merger will achieve such efficiencies, the Department will consider those efficiencies in deciding whether to challenge the merger.

Cognizable efficiencies include, but are not limited to, achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations of the merging firms. The Department may also consider claimed efficiencies resulting from reductions in general selling, administrative, and overhead expenses, or that otherwise do not relate to specific manufacturing, servicing, or distribution operations of the merging firms, although, as a practical matter, these types of efficiencies may be difficult to demonstrate. In addition, the Department will reject claims of efficiencies if equivalent or comparable savings can reasonably be achieved by the parties through other means. The parties must establish a greater level of expected net efficiencies the more significant are the competitive risks identified in Section 3.

4. HORIZONTAL EFFECT FROM NON-HORIZONTAL MERGERS

4.0 By definition, non-horizontal mergers involve firms that do not operate in the same market. It necessarily follows that such mergers produce no immediate change in the level of concentration in any relevant market as defined in Section 2 of these Guidelines. Although non-horizontal mergers are less likely than horizontal mergers to create competitive problems, they are not invariably innocuous. This section describes the principal theories under which the Department is likely to challenge non-horizontal mergers.

4.1 Elimination of Specific Potential Entrants

4.11 The Theory of Potential Competition

In some circumstances, the non-horizontal merger[25] of a firm already in a market (the "acquired firm") with a potential entrant to that market (the "acquiring firm")[26] may adversely affect competition in the market. If the merger effectively removes the acquiring firm from the edge of the market, it could have either of the following effects.

4.111 Harm to "Perceived Potential Competition"

By eliminating a significant present competitive threat that constrains the behavior of the firms already in the market, the merger could result in an immediate deterioration in market performance. The economic theory of limit pricing suggests that monopolists and groups of colluding firms may find it profitable to restrain their pricing in order to deter new entry that is likely to push prices even lower by adding capacity to the market. If the acquiring firm had unique advantages in entering the market, the firms

[25]Under traditional usage, such a merger could be characterized as either "vertical" or "conglomerate," but the label adds nothing to the analysis.

[26]The terms "acquired" and "acquiring" refer to the relationship of the firms to the market of interest, not to the way the particular transaction is formally structured.

in the market might be able to set a new and higher price after the threat of entry by the acquiring firm was eliminated by the merger.

4.112 Harm to "Actual Potential Competition"

By eliminating the possibility of entry by the acquiring firm in a more procompetitive manner, the merger could result in a lost opportunity for improvement in market performance resulting from the addition of a significant competitor. The more procompetitive alternatives include both new entry and entry through a "toehold" acquisition of a present small competitor.

4.12 Relation Between Perceived and Actual Potential Competition

If it were always profit-maximizing for incumbent firms to set price in such a way that all entry was deterred and if information and coordination were sufficient to implement this strategy, harm to perceived potential competition would be the only competitive problem to address. In practice, however, actual potential competition has independent importance. Firms already in the market may not find it optimal to set price low enough to deter all entry; moreover, those firms may misjudge the entry advantages of a particular firm and, therefore, the price necessary to deter its entry.[27]

4.13 Enforcement Standards

Because of the close relationship between perceived potential competition and actual potential competition, the Department will evaluate mergers that raise either type of potential competition concern under a single structural analysis analogous to that applied to horizontal mergers. The Department first will consider a set of objective factors designed to identify cases in which harmful effects are plausible. In such cases, the Department then will conduct a more focused inquiry to determine whether the likelihood and magnitude of the possible harm justify a challenge to the merger. In this context, the Department will consider any specific evidence presented by the merging parties to show that the inferences of competitive harm drawn from the objective factors are unreliable.

The factors that the Department will consider are as follows.

[27]When collusion is only tacit, the problem of arriving at and enforcing the correct limit price is likely to be particularly difficult.

4.131 Market Concentration

Barriers to entry are unlikely to affect market performance if the structure of the market is otherwise not conducive to monopolization of collusion. Adverse competitive effects are likely only if overall concentration, or the largest firm's market share, is high. The Department is unlikely to challenge a potential competition merger unless overall concentration of the acquired firm's market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors discussed in Section 3.4 indicate that effective collusion in the market is particularly likely). Other things being equal, the Department is increasingly likely to challenge a merger as this threshold is exceeded.

4.132 Conditions of Entry Generally

If entry to the market is generally easy, the fact that entry is marginally easier for one or more firms is unlikely to affect the behavior of the firms in the market. The Department is unlikely to challenge a potential competition merger when new entry into the acquiring firm's market can be accomplished by firms without any specific entry advantages under the conditions stated in Section 3.3. Other things being equal, the Department is increasingly likely to challenge a merger as the difficulty of entry increase above that threshold.

4.133 The Acquiring Firm's Entry Advantage

If more than a few firms have the same or a comparable advantage in entering the acquired firm's market, the elimination of one firm is unlikely to have any adverse competitive effect. The other similarly situated firm or firms would continue to exert a present restraining influence, or, if entry would be profitable, would recognize the opportunity and enter. The Department is unlikely to challenge a potential competition merger if the entry advantage ascribed to the acquiring firm (or another advantage of comparable importance) is also possessed by three or more other firms. Other things being equal, the Department is increasingly likely to challenge a merger as the number of other similarily situated firms decreases below three and as the extent of the entry advantage over non-advantaged firms increases.

If the evidence of likely actual entry by the acquiring firm is particularly strong,[28] however, the Department may challenge a potential competition merger, notwithstanding the presence of three of more firms that are ob-

[28]For example, the firm already may have moved beyond the stage of consideration and have made significant investments demonstrating an actual decision to enter.

jectively similarly situated. In such cases, the Department will determine the likely scale of entry, using either the firm's own documents or the minimum efficient scale in the industry. The Department will then evaluate the merger much as it would a horizontal merger between a firm the size of the likely scale of entry and the acquired firm.

4.134 The Market Share of the Acquired Firm

Entry through the acquisition of a relatively small firm in the market may have a competitive effect comparable to new entry. Small firms frequently play peripheral roles in collusive interactions, and the particular advantages of the acquiring firm may convert a fringe firm into a significant factor in the market.[29] The Department is unlikely to challenge a potential competition merger when the acquired firm has a market share of five percent or less. Other things being equal, the Department is increasingly likely to challenge a merger as the market share of the acquired firm increases above the threshold. The Department is likely to challenge any merger satisfying the other conditions in which the acquired firm has a market share of 20 percent of more.

4.135 Efficiences

As in the case of horizontal mergers, the Department will consider expected efficiencies in determining whether to challenge a potential competition merger. See Section 3.5 (Efficiencies).

4.2 Competitive Problems from Vertical Mergers

4.21 Barriers to Entry from Vertical Mergers

In certain circumstances, the vertical integration resulting from vertical mergers could create competitively objectionable barriers to entry. Stated generally, three conditions are necessary (but not sufficient) for this problem to exist. First, the degree of vertical integration between the two markets must be so extensive that entrants to one market (the "primary market") also would have to enter the other market (the "secondary market")[30] simultaneously. Second, the requirement of entry at the secon-

[29]Although a similar effect is possible with the acquisition of larger firms, there is an increased danger that the acquiring firm will choose to acquiesce in monopolization or collusion because of the enhanced profits that would result from its own disapperance from the edge of the market.

[30]This competitive problem could result from either upstream or downstream integration, and could affect competition in either the upstream market or the downstream market. In the text, the term "primary market" refers to the market in which the competitive concerns are being considered, and the term "secondary market" refers to the adjacent market.

dary level must make entry at the primary level significantly more difficult and less likely to occur. Finally, the structure and other characteristics of the primary market must be otherwise so conducive to noncompetitive performance that the increased difficulty of entry is likely to affect its performance. The following standards state the criteria by which the Department will determine whether these conditions are satisfied.

4.211 Need for Two-Level Entry

If there is sufficient unintegrated capacity[31] in the secondary market, new entrants to the primary market would not have to enter both markets simultaneously. The Department is unlikely to challenge a merger on this ground where post-merger sales (or purchases) by unintegrated firms in the secondary market would be sufficient to service two minimum-efficient-scale plants in the primary market. When the other conditions are satisfied, the Department is increasingly likely to challenge a merger as the unintegrated capacity declines below this level.

4.212 Increased Difficulty of Simultaneous Entry of Both Markets

The relevant question is whether the need for simultaneous entry to the secondary market gives rise to a substantial incremental difficulty as compared to entry into the primary market alone. If entry at the secondary level is easy in absolute terms, the requirement of simultaneous entry to that market is unlikely adversely to affect entry to the primary market. Whatever the difficulties of entry into the primary market may be, the Department is unlikely to challenge a merger on this ground if new entry into the secondary market can be accomplished under the conditions stated in Section 3.3.[32] When entry is not possible under those conditions, the Department is increasingly concerned about vertical mergers as the difficulty of entering the secondary market increases. The Department, however, will invoke this theory only where the need for secondary market

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[31]Ownership integration does not necessarily mandate two-level entry by new entrants to the primary market. Such entry is most likely to be necessary where the primary and secondary markets are completely integrated by ownership and each firm in the primary market uses all of the capacity of its associated firm in the secondary market. In many cases of ownership integration, however, the functional fit between vertically integrated firms is not perfect, and an outside market exists for the sales (purchases) of the firms in the secondary market. If that market is sufficiently large and diverse, new entrants to the primary market may be able to participate without simultaneous entry to the secondary market. In considering the adequacy of this alternative, the Department will consider the likelihood of predatory price or supply "squeezes" by the integrated firms against their unintegrated rivals.

[32]Entry into the secondary market may be greatly facilitated in that an assured supplier (customer) is provided by the primary market entry.

entry significantly increases the costs (which may take the form of risks) of primary market entry.

More capital is necessary to enter two markets than to enter one. Standing alone, however, this additional capital requirement does not constitute a barrier to entry to the primary market. If the necessary funds were available at a cost commensurate with the level of risk in the secondary market, there would be no adverse effect. In some cases, however, lenders may doubt that would-be entrants to the primary market have the necessary skills and knowledge to succeed in the secondary market and, therefore, in the primary market. In order to compensate for this risk of failure, lenders might charge a higher rate for the necessary capital. This problem becomes increasingly significant as a higher percentage of the capital assets in the secondary market are long-lived and specialized to that market and, therefore, difficult to recover in the event of failure. In evaluating the likelihood of increased barriers to entry resulting from increased cost of capital, therefore, the Department will consider both the degree of similarity in the essential skills in the primary and secondary markets and the economic life and degree of specialization of the capital assets in the secondary market.

Economies of scale in the secondary market may constitute an additional barrier to entry to the primary market in some situations requiring two-level entry. The problem could arise if the capacities of minimum-efficient-scale plants in the primary and secondary markets differ significantly. For example, if the capacity of a minimum-efficient-scale plant in the secondary market were significantly greater than the needs of a minimum-efficient-scale plant in the primary market, entrants would have to choose between inefficient operation at the secondary level (because of operating an efficient plant at an inefficient output or because of operating an inefficiently small plant) or a larger than necessary scale at the primary level. Either of these effects could cause a significant increase in the operating costs of the entering firm.[33]

4.213 Structure and Performance of the Primary Market

Barriers to entry are unlikely to affect performance if the structure of the primary market is otherwise not conducive to monopolization or collusion.[34] The Department is unlikely to challenge a merger on this ground unless overall concentration of the primary market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors

[33]It is important to note, however, that this problem would not exist if a significant outside market exists at the secondary level. In that case, entrants could enter with the appropriately scaled plants at both levels, and sell or buy in the market as necessary.

[34]For example, a market with 100 firms of equal size would perform competitively despite a significant increase in entry barriers.

discussed in Section 3.4 indicate that effective collusion is particularly likely). Above that threshold, the Department is increasingly likely to challenge a merger that meets the other criteria set forth above as the concentration increases.

4.22 Facilitating Collusion Through Vertical Mergers

4.221 Vertical Integration to the Retail Level

A high level of vertical integration by upstream firms into the associated retail market may facilitate collusion in the upstream market by making it easier to monitor price. Retail prices are generally more visible than prices in upstream markets, and vertical mergers may increase the level of vertical integration to the point at which the monitoring effect becomes significant. Adverse competitive consequences are unlikely unless the upstream market is generally conducive to collusion and a large percentage of the products produced there are sold through vertically integrated retail outlets.

The Department is unlikely to challenge a merger on this ground unless 1) overall concentration of the upstream market is above 1800 HHI (a somewhat lower concentration will suffice if one or more of the factors discussed in Section 3.4 indicate that effective collusion is particularly likely), and 2) a large percentage of the upstream product would be sold through vertically-integrated retail outlets after the merger. Where the stated thresholds are met or exceeded, the Department's decision whether to challenge a merger on this ground will depend upon an individual evaluation of its likely competitive effect.

4.222 Elimination of a Disruptive Buyer

The elimination by vertical merger of a particularly disruptive buyer in a downstream market may facilitate collusion in the upstream market. If upstream firms view sales to a particular buyer as sufficiently important, they may deviate from the terms of a collusive agreement in an effort to secure that business, thereby disrupting the operation of the agreement. The merger of such a buyer with an upstream firm may eliminate that rivalry, making it easier for the upstream firms to collude effectively. Adverse competitive consequences are unlikely unless the upstream market is generally conducive to collusion and the disruptive firm is significantly more attractive to sellers than the other firms in its market.

The Department is unlikely to challenge a merger on this ground unless 1) overall concentration of the upstream market is 1800 HHI or above (a somewhat lower concentration will suffice if one or more of the factors discussed in Section 3.4 indicate that effective collusion is particularly like-

ly), and 2) the allegedly disruptive firm differs substantially in volume of purchases or other relevant characteristics from the other firms in its market. Where the stated thresholds are met or exceeded, the Department's decision whether to challenge a merger on this ground will depend upon an individual evaluation of its likely competitive effect.

4.23 Evasion of Rate Regulation

Non-horizontal mergers may be used by monopoly public utilities subject to rate regulation as a tool for circumventing that regulation. The clearest example is the acquisition by a regulated utility of a supplier of its fixed or variable inputs. After the merger, the utility would be selling to itself and might be able arbitrarily to inflate the prices of internal transactions. Regulators may have great difficulty in policing these practices, particularly if there is no independent market for the product (or service) purchased from the affiliate.[35] As a result, inflated prices could be passed along to consumers as "legitimate" costs. In extreme cases, the regulated firm may effectively preempt the adjacent market, perhaps for the purpose of suppressing observable market transactions, and may distort resource allocation in that adjacent market as well as in the regulated market. In such cases, however, the Department recognizes that genuine economies of integration may be involved. The Department will consider challenging mergers that create substantial opportunities for such abuses.[36]

4.24 Efficiencies

As in the case of horizontal mergers, the Department will consider expected efficiencies in determining whether to challenge a vertical merger. See Section 3.5 (Efficiencies). An extensive pattern of vertical integration may constitute evidence that substantial economies are afforded by vertical integration. Therefore, the Department will give relatively more weight to expected efficiencies in determining whether to challenge a vertical merger than in determining whether to challenge a horizontal merger.

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[35]A less severe, but nevertheless serious, problem can arise when a regulated utility acquires a firm that is not vertically related. The use of common facilities and managers may create an insoluable cost allocation problem and provide the opportunity to charge utility customers for non-utility costs, consequently distorting resource allocation in the adjacent as well as the regulated market.

[36]Where a regulatory agency has the responsibility for approving such mergers, the Department may express its concerns to that agency in its role as competition advocate.

5. DEFENSES

5.1 Failing Firm

The "failing firm defense" is a long-established, but ambiguous, doctrine under which an anticompetitive merger may be allowed because one of the merging firms is "failing." Because the defense can immunize significantly anticompetitive mergers, the Department will construe its element strictly.

The Department is unlikely to challenge an anticompetitive merger in which one of the merging firms is allegedly failing when: 1) the allegedly failing firm probably would be unable to meet its financial obligations in the near future; 2) it probably would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act;[37] and 3) it has made alternative offers of acquisition of the failing firm[38] that would keep it in the market and pose a less severe danger to competition than does the proposed merger.

5.2 Failing Division

A similar argument can be made for "failing" divisions as for "failing" firms. A multidivisional firm may decide to leave a particular line of business by selling or liquidating a division. If the specific conditions set out below are met, the Department will consider the "failure" of the division as an important factor affecting the likely competitive effect of the merger. First, the proponents of a merger involving a "failing" division must establish, not based solely on management plans, which could be prepared simply for the purpose of creating evidence of intent, that the division would be liquidated in the near future if not sold. Second, the proponents of the merger also must demonstrate compliance with the competitively preferable purchaser requirement of the "failing firm defense".

[37] 11 U.S.C. §§ 1101-1174 (1982).

[38] The fact that an offer is less than the proposed transaction does not make it unreasonable.